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Review of the Peanut Program

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Presented by:

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Mr. Chairman and Members of the Committee:

My name is Ben Smith and I am the Manager of Peanut Operations for Tom's Foods of

Columbus, Georgia. I have been intimately involved in the peanut business for over 30 years and I am a long-time member of the American Peanut Product Manufacturers, Inc. (APPMI). I am here today on behalf of APPMI to express the organization's views about the current peanut price support program and the need to institute market-oriented reforms of the program so that everyone in the peanut chain – from farmers to shellers to employees in the food industry to consumers – can share in the fruits of a growing, prosperous peanut industry.

The peanut product manufacturers want to be a part of a healthy, viable industry that has a strong future of growth. As a peanut manufacturer in south Georgia I have worked and lived among growers all of my life, so I know that commodity programs and policies are critical to local communities. It has been difficult for me to witness the effect of government policies that restrict crop production and keep prices at economically unjustifiable levels. Surely, this is a prescription for the demise of an industry and thus a serious situation for the countless families who derive their livelihood from it.

As a Georgian, I also have seen what can happen when all segments of an industry pull together to solve common problems. There is no better example of that than the cotton, where a unified approach to farm policies and programs has led to a resurgence of cotton production in Georgia.

I believe that the peanut industry likewise can – and should – unite in support of a new peanut program that benefits all segments of the industry. Today, more than any time since the peanut program was established, I sense that there is a real commitment on the part of most of those in the industry to do just that. In fact, Mr. Chairman, today you are witnessing an historic moment with all three segments of the peanut industry – growers, shellers, and manufacturers – rallying behind a single peanut program, the marketing loan.

Peanut growers from Georgia, Florida and West Texas have proposed a marketing loan program to take the place of the current peanut program. Shellers have endorsed this approach. We as manufacturers endorse this approach. And we are willing to sit down anytime, anywhere, with anybody to work out the details of this bold new idea that we think can chart a course of growth and prosperity and fairness for everyone associated with the peanut industry.

A marketing loan program will make U.S. peanut growers competitive with other peanut growers in the international marketplace. The peanut marketing loan program proposed by the Georgia, Florida, and West Texas peanut growers is similar to the current marketing loan programs for cotton, rice, wheat, corn and other commodities. A marketing loan simply authorizes peanut growers to repay their commodity loan at a lower "market" level, which will make them competitive with any other growers in the world.

The Marketing Loan

Under a marketing loan program, peanut farmers would no longer be treated differently and a significant component of their cost of production – quota rent – would be eliminated; consumers would benefit from lower peanut prices; U.S. manufacturers would sell more peanut products and thus create more jobs; and U.S. producers of other agricultural commodities would not be compromised in their efforts to find new markets for their commodities.

Marketing loans are designed to achieve two goals simultaneously – to allow the producer to receive no less than the loan rate for their commodity, while letting the price of that commodity respond to market demand. These two goals are achieved by allowing producers to repay their loans at the market price if the market is below the loan rate, and keep the difference. In that way, the federal government avoids assuming ownership of the commodity – and all the costs and complications of government storage and disposal of surplus inventories – and stocks can flow freely into market channels. The result is income support without a price floor.

Existing Marketing Loan Features

Marketing loans in the form of nonrecourse loans were made available to producers of wheat, feed grains, upland and extra long staple (ELS) cotton, rice, soybeans and minor oilseeds under the Market Transition Act ("AMTA") provisions in the Federal Agricultural Improvement and Reform ("FAIR") Act of 1996. Loan rate caps for each of these commodities were specified in the law. Marketing loan repayment provisions apply when market prices drop below the established loan rates.

For all loan commodities, except ELS cotton, USDA must use marketing loan repayment provisions that allow producers the option of repaying marketing loan assistance loans at levels below the original loan rate plus accrued interest. These provisions reduce the chance that commodities pledged as collateral for a marketing assistance loan will become the property of the federal government through loan forfeitures.

For farmers who forego the use of marketing assistance loans, loan deficiency payment rules apply. Loan deficiency payments are a commodity payment program authorized by the Food Security Act of 1985 that makes direct payments, equivalent to marketing loan gains, to wheat, feed grain, upland cotton, rice or oilseed producers who agree not to obtain nonrecourse loans, even though they are eligible. The payment rate for loan deficiency payments would be set at the rate needed to make the per unit benefit the same as received by producers who took out loans and repaid them at the marketing loan repayment rates.

Marketing Loan as Applied to Peanuts

The peanut loan rate in a marketing loan program would need to be set at a level to have the effect of capturing a much larger share of the world peanut market. This price would certainly be doable, considering that the current support price for quota peanuts is \$610 per ton, but the cost of quota rents are estimated to be as high as \$240 to \$300 per ton. Once the payment of quota rent is eliminated, a major cost of producing peanuts is eliminated. Of course, elimination of the quota would allow efficient farmers to optimize their farming operations by planting more peanuts.

In addition, the marketing assessment on producers and first purchasers of peanuts would be eliminated. Peanut growers and shellers would no longer be required to pay marketing assessments of approximately $10 million annually.

Peanut manufacturers understand that peanut quota has been capitalized into the value of the quota owners' land and that financial institutions have lent money based upon this asset. We understand that doing away with the quota system for quota owners is analogous to the taking away of a vested property right conferred upon them by the federal government. Thus, a decoupling payment should be made available to quota owners to compensate them for the government taking of a capitalized property interest. Peanut quotas have been leased, bought, and sold for many years. Many farmers have paid substantial sums for the quota since 1996. Any government compensation for the loss of this property interest should not be subject to payment limitations.

A federally financed buyout of peanut production quotas would qualify for the "green box" under the Uruguay Round Agreement on Agriculture (URAA). The basic criterion for inclusion in the green box is that policies "have no, or at most minimal, trade-distorting effects or effects on production." Generally, this means that support must be: 1) publicly funded (i.e., not directly funded by consumers), and 2) non-price supporting. A quota buyout would meet these criteria since a buyout would not require anyone to produce or not produce peanuts.

Reasons to Move to a Market-Oriented Peanut Program

A key motivation for shifting from a peanut quota program to a marketing loan program is the strong incentive that the current program provides for other countries to increase planted acreage of peanuts as U.S. peanut farmers continue to restrict the amount of peanut acreage. Other U.S. commodity growers have already explicitly recognized that it was not in their interest to manage world supplies by limiting planted acreage only in the United States.

The North American Free Trade Agreement (NAFTA) changed the game for the peanut industry by setting in motion the lowering of tariffs on peanut imports from Mexico. In 2003, peanut butter from Mexico will enter the United States duty-free and the over-quota tariff-rate will be low enough for peanut kernels from Mexico to begin entering the U.S. market in more significant quantities. In 2008, Mexican-origin peanuts will be allowed to enter the U.S. market in unlimited quantities. Therefore, the time to act is now to ensure that U.S. growers will remain competitive.

If peanut growers do not move to some sort of marketing loan program in the upcoming farm bill, they will continue to fuel the growth of production in Argentina, Mexico and other countries, that will increasingly gain expanded access to the U.S. consumer market. New multilateral trade agreements, including upcoming World Trade Organization (WTO) and the Free Trade Area of the Americas (FTAA) agreements have a high probability of reducing very restrictive tariffs on peanut imports into the United States. WTO and FTAA negotiations are likely to lead to more significant tariff reductions on peanut imports because prohibitively high U.S. tariffs on peanut products in excess of 100% stand in stark contrast to minimal or zero tariffs on most other commodities.

If challenged under the WTO, the U.S. peanut program could be determined to be in violation of WTO commitments as an export subsidy. In a case brought by the United States against the Canadian two-price dairy program, the WTO ruled that Canada's high domestic price and lower export price constituted an export subsidy. In 1999, Canada agreed to implement reforms in its dairy program to comply with the WTO ruling, and the United States continues to challenge Canada's dairy reforms as inadequate. The U.S. two-tier peanut price support program – where quota peanuts for domestic edible use receive a high loan rate, while non-quota peanuts for export are eligible for a lower support price – is the same system as the Canadian two-tier pricing program.

The on-going WTO and FTAA negotiations, the existing GATT and NAFTA framework, and the upcoming farm bill each separately and in concert present serious challenges for the existing peanut program. We are encouraged that many peanut growers have acknowledged that the current commodity policy for peanuts is inconsistent with the existing and future course of world agricultural trade policy.

U.S. peanut growers can no longer rely on a quota system of limits on domestic production imposed by the government and high tariffs on peanut imports to provide a shield to healthy competition. In fact, the peanut program is the only remaining food commodity program that continues to rely on a quota system for domestic production. Since U.S. peanut growers produce some of the best quality peanuts in the world, U.S. peanut product manufacturers continue to prefer purchasing domestically produced peanuts. Furthermore, the opportunity is ripe for peanut growers to quickly move to a competitive program before its foreign competitors capture too large a share of the U.S. and international peanut market.

The health of the U.S. peanut industry is dependent on consumer demand. Everything being equal, an expanding demand will generate an expanding industry. The price sensitivity of peanut demand is evidenced by the fact that the 10% quota price reduction in the 1996 FAIR Act led to a 10% growth in peanut usage in the first four years after implementation of the farm bill. In stark contrast, rising peanut quota loan rates in the five years leading up to the 1996 farm bill had caused peanut usage to fall by 16%.

A more significant loan rate reduction will stimulate domestic peanut demand and discourage the growth of peanut imports. If domestic peanut prices were competitive with imported peanuts, U.S. peanut growers could provide the 150,000 to 170,000 tons of farmer stock peanuts supplied by imports.

In addition, the current peanut program requires the U.S. Department of Agriculture to purchase higher-priced quota peanuts for its various food assistance programs. Elimination of the peanut quota program would make peanuts more affordable, so USDA would be able to purchased more peanut products, such as peanut butter for the National School Lunch Program and other feeding programs.

Clearly, the current peanut program is in need of reform. It discriminates unfairly between quota holders and additional peanut growers; it fosters the growth of competing peanut production abroad; it encourages the export of U.S. manufacturing jobs; and it compromises the ability of other U.S. farmers to increase their access to world markets.

Problems with a $780 per ton Support Price and Maintaining a Quota System

The National Peanut Growers Group (NPGG) has an alternative proposal for the peanut program. The NPGG recommends a program which maintains the basic quota system of overly restricted production and sets the support price at an unrealistically high level of $780 per ton. This proposal is the antithesis of a market-oriented program and in fact would only hasten the decline of the U.S. peanut industry.

The NPGG proposal continues the current inequity of government treatment between quota and additional growers. Under the NPGG proposal, only quota growers would be allowed to grow peanuts for the domestic edible market. Additional growers would continue to be restricted to growing peanuts for export and crushing and would only be eligible for a much lower loan level. In other words, additional peanut growers would still be denied the opportunity to sell their peanuts in their own country and would be denied benefits provided by the federal government to other peanut growers.

There is no precedent in other commodities or in farm policy history for the NPGG proposal. While the proposal is presented as similar to the Cotton Step 2 Program, it is quite different. The Step 2 Program is merely a supplemental program for the cotton marketing loan program. The cotton marketing loan is the vehicle for supporting the income of cotton farmers and keeping the price of cotton competitive in international marketplace. When U.S. cotton is still not competitive in world markets, the Step 2 program makes payments to cotton shippers and others to make cotton competitive.

The NPGG proposal provides a greatly expanded role for area marketing associations. Farmers would no longer be able to sell quota peanuts in the market. All quota peanuts would go to the area associations and shellers could buy quota peanuts only from area associations.

There is no precedent in U.S. farm policy for requiring all farmers to sell all of their commodity to designated government-backed associations. There is no other U.S. farm program where a farmer is required to sell their product to the government. In fact, it could be said that the proposal would set up the area marketing associations as “state trading enterprises” (STEs). Therefore, this proposal runs counter to the efforts of U.S. agricultural trade negotiators to get other countries to dismantle their STEs.

Furthermore, there is no precedent for avoiding the issue of payment limitations by making government payments to the commodity association rather than the farmer. If it were possible to do this to avoid payment limitations, other commodity groups would have established such a mechanism.

Perhaps even more so than the current peanut quota program, the NPGG proposal likely would be determined to be in violation of WTO commitments if challenged, inasmuch as it maintains a two-price system with government payments coupled to production. In the Canadian dairy case, Canada unsuccessfully argued that the Canadian system did not constitute an export subsidy because it did not directly pay farmers to export. A new two-price peanut program with payments to farmers coming directly from the federal government would be a clear violation of WTO commitments on export subsidies.

Serious Reform or Elimination of the Peanut Administrative Committee

In developing a new peanut program, it is critical that Congress focus on removing the unnecessary costs of the current system of marketing peanuts in the United States. One such entity which has unduly raised costs for the peanut industry is the Peanut Administrative Committee (PAC). This quasi-government committee manages U.S. peanut quality standards.

While the PAC may have some legitimate role in overseeing outgoing peanut quality standards, it has no useful purpose in setting incoming quality regulations, especially since it has a track record of making decisions that have stifled progress in the peanut industry. In fact, the PAC has a history of standing in the way of new improvements, innovations and technological advances that could benefit the peanut industry. Therefore, we urge the subcommittee to carefully examine the role of the PAC with a view toward significant reform or elimination of the PAC.

The Choice Between Peanut Program Proposals

In conclusion, there are two competing peanut program proposals before the committee today – one which turns the hands of the clock backwards and makes the current situation worse versus one which is more consistent with other commodity programs and creates opportunity for all those up and down the peanut chain.

APPMI believes the choice is obvious. We applaud the courage of the Georgia Peanut Commission, the Western Peanut Growers Association, the Florida Peanut Growers Association, the Panhandle Peanut Growers Association, and the Georgia Peanut Producers Association in advocating reforms to the peanut program that will allow the industry to become more competitive with foreign producers. A marketing loan will place the peanut program on a sound basis for the future by making it consistent with farm programs for other basic agricultural commodities. This approach will enable the American peanut industry to thrive over the next decade.

If the committee is prepared to entertain the marketing loan approach as a way to address the problems of the current peanut program, we stand ready to work with you, the members of this Committee, growers, shellers, consumers, and labor unions, to hammer out the details of the marketing loan program, to enact it into law and to get about our business – the business that is of common interest to us all – growing the peanut industry.

Thank you for this opportunity to express the views of APPMI. I would be happy to respond to any questions.